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Letter Ruling 10-6: Application of 830 CMR 63.32B.2(8)(f), Limitation on Use of Pre-combination NOL

October 4, 2010

You have requested a ruling on behalf of ***** (“Company”), a Massachusetts corporate taxpayer, with respect to the application of certain of the rules set forth in the Department’s regulation on combined reporting, 830 CMR 63.32B.2. In particular, you inquire as to the applicability to the Company of the limitation on the utilization of pre-2009 net operating loss carry forwards imposed by the combined reporting regulation at 830 CMR 63.32B.2(8)(f).

ISSUE

The combined reporting regulation provides transitional rules regarding the utilization of a net operating loss (“NOL”) carry forward derived from a loss incurred in a tax year when Massachusetts imposed its tax on the loss corporation on a separate corporation basis, to be used in a tax year beginning on or after the effective date of the law mandating combined reporting, January 1, 2009. See G.L. c. 63, § 32B. The regulation at 830 CMR 63.32B.2(8)(f) provides a limitation on the use of such a pre-combination NOL that is calculated using the apportionment factors of the combined group member from both the loss year and the tax year in which the member seeks to use the NOL carry forward. In cases in which the NOL is carried forward for two or more tax years, the apportionment factors of the combined group member from these intervening tax years are also relevant.

You ask whether the above-referenced limitation of a group member’s use of its pre-combination NOL carry forwards applies to a Massachusetts-based corporation like Company that did not have income from business activity taxable in another state in the pre-combination taxable year in which the underlying losses were incurred, does not have business activity taxable in another state in the post-combination 2009 taxable year in which the corporation seeks to use the NOL carry forwards, and did not have business activity taxable in another state in any intervening taxable year, such that the whole of the corporation’s taxable net income in all the relevant tax years is attributed to Massachusetts. Your inquiry is also predicated on the fact that the only corporation subject to the corporate excise that was affiliated with Company during the tax years at issue, 2004 to 2009, was the Company’s parent corporation for the tax years 2008-2009, for which tax years this parent corporation also had no business activity taxable in another state.

FACTS

http://www.mass.gov/...+By+Year(s)&L6=2010+Rulings&sid=Ador&b=terminalcontent&f=dor_rul_reg_lr_lr_10_6&csid=Ador[11/3/2010 1:54:33 PM]

Company was incorporated in Delaware and is based in Massachusetts. It develops certain medical products that provide sustained release of drugs. For each of the tax years relevant to this ruling, Company was 100% owned by ***** ("Parent") which is a publicly traded holding company that reincorporated in Delaware ***** in June of 2008. For the 2009 tax year, Parent was also the 100% owner of ***** ("Subsidiary Two"), a ***** entity not at issue in this ruling.

Company did not have business activity taxable in another state for the tax years 2004-2008 and consequently attributed 100% of its income to Massachusetts for those years. Company has Massachusetts NOL carry forwards of approximately \$ ***** million that derive from losses incurred in each of its tax years 2004 through 2008 that it has not previously been able to use in whole or part, as it has not previously had any Massachusetts income to offset against these losses. The NOLs for Company from each year which would be available to carry forward into 2009 are as follows: for tax year 2004, \$*****; for tax year 2005, \$*****; for tax year 2006, \$*****; for tax year 2007, \$*****; for tax year 2008, \$*****; resulting in a total of NOL carry forwards from tax years 2004-2008 of \$*****. However, Company anticipates reporting significant Massachusetts taxable income for tax year 2009.

For tax years 2004-2008, Parent was a "holding company." For the tax years 2004-2007, Parent had no Massachusetts nexus. For the tax year 2008, Parent had Massachusetts nexus but, since it had no business activity taxable in another state, Parent did not apportion its income but rather allocated all of its income to Massachusetts. You represent that there were no other corporations that were affiliated with Company that had Massachusetts nexus for the tax years 2004-2009.

Both Company and Parent have taxable year ends of December 31 for tax year 2009. For their tax years ended December 31, 2009, Company and Parent are engaged in a unitary business and are required to file a combined report in Massachusetts. You represent that neither corporation will have business activity taxable in another state in tax year 2009 and that, therefore, 100% of the combined group's taxable income for that tax year is to be attributed to Massachusetts. You also represent that there are no other corporations, including Subsidiary Two, which are members of the combined group in tax year 2009.

DISCUSSION

For tax years beginning on or after January 1, 2009, a corporation is required to file a combined report when it is subject to tax under G.L. c. 63 and is engaged in a unitary business with one or more other corporations that are required to be included in a combined report pursuant to G.L. c. 63, § 32B. In contrast, under the state's pre-existing separate corporation tax reporting law, each corporation with nexus filed a tax return that included only the separately-determined income and apportionment factors of that corporation.

Chapter 63, section 30(5)(b) allows a corporate taxpayer to carry forward certain unused losses sustained in prior tax years not previously offset against its taxable income. Prior to the enactment of the combined reporting statute, all Massachusetts NOLs were to be carried forward by an individual corporate taxpayer to be applied by the taxpayer in future tax years, consistent with the rules for using an NOL carry forward, on a pre-apportionment basis. Further, the Massachusetts combined reporting statute allows a corporate taxpayer subject to combined reporting that has a NOL carry forward from a tax year that began prior to its becoming subject to combined reporting to apply that carry forward against the taxpayer's share of the combined group's taxable income.

Chapter 63, section 32B(f) provides for the promulgation of a regulation to explain how a corporate taxpayer's NOL carry forwards that derive from tax years prior to the effective date of the combined reporting statute are to be applied by the taxpayer as to tax years that begin subsequent to this effective date. In particular, § 32B(f) provides that any such regulation will address the "application of any carry forwards, including the sharing of any net operating loss . . . carry forwards that are attributable to the activities of the combined group's unitary business, but the carry forward of losses . . . that arise before the effective date of this section shall be available only to the extent permitted by law as in effect before the effective date; . . . "

The combined reporting regulation includes rules that allow corporate taxpayers to utilize their NOL carry forwards against their share of a combined group's taxable income on a post-apportionment basis. See 830 CMR 63.32B.2(8)(d) and (e).

The Commissioner's regulation at 830 CMR 63.32B.2(8)(d) provides:

Where a taxable member of a combined group has a NOL carry forward that derives from a loss incurred in a taxable year beginning prior to January 1, 2009, the carry forward shall remain available to be deducted by the taxpayer that incurred the loss in a subsequent tax year as permitted under Massachusetts law as in effect during the year that the loss was incurred, subject to the limitation set forth in 830 CMR 63.32B.2(8)(f) (emphasis supplied).

The limitation on use of a pre-combination NOL carry forward set forth in 830 CMR 63.32B.2(8)(f) provides:

1. Where a taxable member of a combined group is carrying forward a NOL from a year or years beginning prior to January 1, 2009, or from a year or years in which the corporation was not a member of a combined group, the use of the corporation's pre-apportionment NOL from such year(s) is limited to the amount of the current year combined group taxable income that would be apportioned to the member as determined by using:

- a. the dollar amounts of the member's Massachusetts apportionment factor numerators in the year(s) in which the loss was incurred (determined, in the case of the sales factor, by excluding all 'throwback sales' other than destination sales 'thrown back' in the year of the loss from jurisdictions in which no member of the combined group is subject to tax in the year the NOL deduction is taken) and
- b. the current year group denominators.

The purpose of the limitation at 830 CMR 63.32B.2(8)(f) is to provide a transition from the pre-combination to post-combination statutory regime so that a taxable member of a combined group can realize an appropriate benefit from its pre-combination NOLs. The limitation is intended to prevent, inter alia, a combined group that includes a taxable member that incurred an NOL prior to becoming subject to combined reporting from transferring Massachusetts property or payroll to such member in an attempt to enhance the post-apportionment value of the member's loss in the context of combined reporting. The limitation generally restricts the loss corporation's post-apportioned NOL carry forward by applying the in-state apportionment factors of the corporation that existed at the time that the loss was incurred to determine the amount of combined group income of the loss corporation that may be offset by its separate company loss carry forward.

You represent that the application of the second limitation at 830 CMR 63.32B.2(8)(f) to the Company's intended use of its NOL carry forwards in tax year 2009 would produce an unintended result. As noted, Company has attributed 100% of its income to Massachusetts in every relevant tax year beginning with the first tax year in which it incurred a loss resulting in the NOL carry forwards that it seeks to use in tax year 2009, up through and including the 2009 tax year, and no affiliate corporation of Company was both subject to Massachusetts tax and subject to Massachusetts apportionment for any of the Company's loss years. In the absence of the second limitation imposed by the regulation, all of the Company's NOL carry forwards would be available to offset its 2009 share of the combined group's taxable income. In contrast, if the limitation applies to Company's use of its pre-combination NOL carry forwards, Company will only be able to use a small fraction of its

NOL carry forwards against its 2009 share of the combined group's income.

The NOL carry forward limitation in CMR 63.32B.2(8)(f) is intended to address a possible abuse or inequity in the application of an apportioned loss in the context of combined reporting. The limitation is intended to address situations where the taxpayer that incurred a loss that gives rise to an NOL carry forward was subject to apportionment in (1) the loss year, (2) the tax year in which the taxpayer seeks to use the NOL carry forward, or (3) an intervening tax year. Further, the limitation is intended to address situations where, even assuming that none of the above conditions are met, one or more of the taxpayer's affiliated corporations were both subject to Massachusetts nexus and subject to Massachusetts apportionment in one or more of the loss years.

In the case of Company, neither member of the combined group can apportion its income in tax year 2009, the tax year in which Company seeks to use its NOL carry forwards, because neither corporation has income from business activity that is taxable in another state during this tax year. Consequently, the combined group cannot apportion its income for tax year 2009. Given these facts, where the NOLs to be utilized have not previously been apportioned by Company, and Company had no affiliated corporations that were subject to Massachusetts nexus that could apportion their income in any of the loss years, there is no basis for the application of the NOL carry forward limitation. Compare 830 CMR 63.32B.2(7)(k), which explains that where no member of the combined group is entitled to apportion, the combined group's taxable income is merely "attributed" to the group members, as opposed to being apportioned.

CONCLUSION

Under the facts presented, the limitation on the use of pre-combination NOL carry forwards set forth at 830 CMR 63.32B.2(8)(f) does not apply where Company, a corporation that is subject to combined reporting, seeks to utilize such pre-combination NOL carry forwards and (1) Company and its combined group members are to attribute 100% of the group's income to Massachusetts in the tax year that Company seeks to use the carry forward; (2) there are no prior tax years for which the Company and its affiliated corporations were subject to combined reporting; (3) Company attributed 100% of its income to Massachusetts in each of the pre-combination tax years in which it either incurred or carried forward the NOLs that it seeks to use; and (4) Company had no affiliated corporations that were subject to Massachusetts nexus that could apportion their income in any of Company's loss years.

Very truly yours,

/s/Navjeet K. Bal

Navjeet K. Bal
Commissioner of Revenue

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